Q&A: MEETING WITH INSTITUTIONAL INVESTORS

9/12 Draft

Q-1. **PM proxy activism.** What is your proxy voting policy with regard to investments PM holds?

A. We are in compliance with the new regulations issued by the Department of Labor, and we do not plan any changes to our policy. We have, however, sent a letter to all equity managers, reminding them that each proxy should be voted in the best interests of Philip Morris plan participants. We believe that the investment managers are in the best position to evaluate the issues of each company in which they have stock on a case-by-case basis.

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Q-2. **Proxy issues at PM.** What is the schedule for shareholder proposals and other matters to bring before your next annual meeting?

A. As [page 22 of] our 1994 proxy statement specified, notice of a nomination or other matters to be brought before the 1995 annual meeting must be received by the company between October 8th and November 7th, 1994. For a matter to be included in our proxy statement and proxy for the 1995 annual meeting, the company must receive notice on or before November 7th. The proxy statement provides additional details.

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Q-3. **Shareholder suits (e.g. Florida State Board of Administration) re nicotine.** Why shouldn't we join the people suing you for concealing the addictive nature of nicotine, and for artificially pumping up your stock price?

A. The most important reason you shouldn't join in these claims is that the shareholder suits you are referring to, such as the Steiner/Kurzweil suit in New York and the suit brought by the Florida State Board, are without merit. In fact, to the extent that pursuing such groundless claims could needlessly depress our stock price until the lawsuits unravel, you would only be lowering the value of your own investment.

Many lawsuits like this are brought by plaintiffs and attorneys who expect to make money by settling. However, we have never settled a smoking and health lawsuit, and we certainly have no intention of settling this one. *[FYI: We are planning to file a motion to dismiss the Steiner/Kurzweil suit during the week of the 21st.]*

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Q-4. **Corporate governance principles.** Will the Philip Morris Board adopt the GM or TIAA-CREF principles of corporate governance?

A. For many years, Philip Morris has operated on principles of corporate governance, many of which are embodied in both the General Motors and the TIAA-CREF principles. Formalizing our principles of corporate governance is something we are taking a closer look at. *[Note: the draft PM governance principles, together with the GM and TIAA-CREF principles, are included in this briefing book under "Corp. Governance Principles."]*

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Q-5. **The Board: Members.** Will you consider adding more "independent" Directors, partly to replace John Richman? Will you consider someone we propose?

A. We do believe that the majority of our Board members should be independent directors. This excludes former or current employees of the Company, as well as directors with personal or financial relationship with the Company which could interfere with the loyalty of the director to the shareholders.

In principle, Philip Morris subscribes to the definition of independence used by the New York Stock Exchange. The Exchange considers a director who has a material relationship with the Company — for instance as a professional advisor, consultant or legal counsel — to be not independent. According to the Exchange's definition, however, customary commercial transactions, undertaken at arm's length in the ordinary course of business, are not necessarily material and do not disqualify a director from independent status if, in the board's discretion, the relationship would not interfere with the individual's ability to exercise independent judgment.

Our Board currently consists of 17 members, 12 of whom are "independent" and "outside" Directors, and 5 of whom are "inside" directors (4 of whom are management directors). [Hamish Maxwell is an inside but non-management director.] However you count them, independent, outside or non-management Directors account for the vast majority on the Board. While we have no current plans to expand the Board, we do look at possible candidates from time to time, and it is likely that any new Directors added will not be management Directors.

We do believe that a roster of between 12 and 18 Board members is appropriate. *[FYI: the trend is toward shrinking Board sizes.]* Proposals to add members to the Board, and the initial screening of new members, are the responsibilities of the Nominating Committee. The Nominating Committee consists entirely of outside Directors. [Harold Brown, William H. Donaldson, Jane Evans, Robert E.R. Huntley, John D. Nichols, John S. Reed.]

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Q-6. **The Board: Evaluation procedures.** How do you formally evaluate the Chairman and the Board as a whole?

A. The Nominating Committee assesses the performance of the Board and makes recommendations to the Board on corporate governance matters such as the functions of the committees of the Board and the Company's relations with its shareholders. All of the members of the Nominating Committee are outside directors.

Evaluation of the Chairman (includes evaluation of the Chief Executive Officer, when they are separate officers).

Each year, the outside directors evaluate the Chairman, and the results of that evaluation are communicated to the Chairman by the Chair of the Compensation Committee. The evaluation is based on objective criteria, including the performance of the business, the accomplishment of long-term strategic objectives, leadership skills and the development of management.

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Q-7. **The Board: Compensation and stock ownership.** Will you consider paying your Board members solely in stock, as Travelers and Scott Paper are doing? Are you considering other ways of encouraging Board members to think more like owners?

A. We encourage our non-employee directors to own PM stock because we recognize that ownership of stock helps to align the directors' interests with those of other stockholders. We have therefore been paying non-employee directors partially with stock — worth as much as their *[$26,000]* annual cash retainer — since May 1990. *[The most recent stock payment came to 400 shares, worth $21,600 when granted on 5/2/94. Scott Paper's payment to its board members was 1,000 shares, worth $53,250 when granted on 7/19/94.]*

We consider many compensation possibilities. Each year, the Compensation Committee of the Board receives and reviews a report from Management which compares our Board's compensation to that of boards at other large companies. The report also contains recommendations. The Compensation Committee suggests any changes in Board compensation, but changes are approved only after full discussion with the entire Board.

[Note: the 1994 proxy, included in the back pocket of this notebook, disclosed stock ownership of Board members on page 8.]

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Q-8 **Diversity.** Do you intend to recruit more women and minorities to the Board?

A. We are always looking at the possibility of bringing qualified women and minorities onto the Board, and issues of diversity are among the matters we consider in recruiting new Board members. Currently, two of our Board members are women, and one is African-American.

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Q-9. **Poison pill.** Why don't you redeem the shareholder Rights [the poison pill] issued in 1988, or at least submit the issue to an affirmative vote of all the shareholders? *[Note: although the redemption proposal came from the Teamsters in 1993 and 1994, we do not anticipate this question from Bill Patterson, the Teamsters' representative at this meeting.]*

A. The Rights Plan was adopted by the Board in 1989 in an atmosphere of almost daily reports of hostile takeover attempts. Many of these attempts were given additional power and credibility by the activities of short-term investors, or arbitrageurs, who did not necessarily serve the interests of other shareholders in the target company.

The Board believed then, and continues to believe, that the Rights Plan places the Company in the best position to negotiate and evaluate any potential offer, and to protect shareholders from potential abuses — thus permitting the Board to secure the best possible terms for all shareholders. The Rights Plan cannot, and will not, prevent a takeover which the Board determines to be in the best interests of the shareholders. And while we have no way of knowing whether we would ever be a viable takeover candidate, the lower our stock price is (in relation to our earnings), the more attractive we could be to opportunistic takeover specialists.

As you probably know, our stock price has indeed been depressed, often during times of negative news about our tobacco business. In fact, in March 1993 we analyzed the relationship between various media events and our share price during the prior twelve months. The conclusion was inescapable: there was a direct — and often dramatic — correlation between negative tobacco-related news events and a loss of shareholder value. *[Note: we do not want to imply that correlation means cause and effect.]*

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Unfortunately, whether the news event was based on fact or speculation did not matter. Almost without exception, the impact was a loss of value, sometimes a significant one. And during a string of negative news reports, the loss was compounded. However, a strongly positive event for the industry was never linked with an equally dramatic return in value. (This has also held true, we believe, in 1994.)

Thus, we have reason to believe that a compounding of possibly erroneous news stories could be accompanied by a decline in our market price to a level that would make your company attractive to opportunistic takeover specialists — who would not necessarily have your interests in mind. Under these circumstances, the Rights Plan gives the Board useful negotiating room, and time, to protect your interests.

We believe that the proponents of the redemption measure have been somewhat persuaded by these arguments. However, as you can appreciate, many members of the Council for Institutional Investors oppose Rights Plans like ours as a matter of principle. We respect their reasons, but we believe that they do not apply to the situation at Philip Morris.

As for submitting the Rights for the approval of all the shareholders, in effect *[although not in an affirmative vote]* the shareholders have approved it twice in a row, at our last two annual meetings. In both meetings, the proposal to redeem the Rights, or submit them to an affirmative shareholder vote, was defeated by the votes of shareholders representing a majority of the shares outstanding.

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Q-10. **The Board: Meetings with investors.** Do you plan to hold more meetings like this on a regular basis? *[See also Q-24.]*

A. As you can understand, these are partly get-acquainted meetings, because we are a new management team, and because some of you have expressed interest in meeting with non-management members of the Board. Over time, I'd like to get to the point where we have an ongoing relationship. *[For PM management:* And if you feel we need to talk, I urge any of you to pick up the phone and give me a call.]

We do have an active investor relations group. Hoby Millington and Mike Kenny meet with investors all the time, sometimes with senior management present. And Dede Bartlett and Al Carney have met with some of you concerning a few of the issues we are discussing today. You are always welcome to contact them, or the rest of us at Philip Morris, directly.

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Q-11. **The Board: Messrs. Maxwell, Richman, Wolf.** What kind of a role do you expect Mr. Maxwell to play going forward? How often do you meet with him? How long do you expect him to remain on the board, and why did he sell his stock? *[Other questions may concern Mr. Richman's resignation, and Mr. Wolf's continued membership.]*

Hamish Maxwell:

We value Hamish's counsel as a member of the Board. We meet with him, usually with other Board members, monthly.

[Notes: (1) Hamish Maxwell will speak for himself if there are questions concerning his sale of stock. (2) Although Mr. Maxwell is a non-management director, we consider him an inside director for corporate governance purposes.]

John Richman:

John let us know that he decided to resign from the Board for personal reasons. Accepting John's resignation was among the actions which we took at our August 31st meeting. *[FYI — We have no current plans to seek a replacement director.]*

Stephen Wolf:

Company policy provides that a Director whose principal occupation has changed since election to the Board submit a written resignation to the Nominating Committee. The Committee then recommends appropriate action to the Board. However, the Board was aware of Mr. Wolf's situation at UAL at the time he became a director. Upon review of the matter, it was determined that applying the policy in this instance would be inappropriate.

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Q-12. **Split-up/proxy fight.** You have made a point of saying that there are no plans to separate food and tobacco at this point. But some of us are threatening a proxy fight. What are you doing to appease us?

A. As we have said, the Board concluded that splitting up the businesses would probably not have created a meaningful and enduring increase in value for you — or any of us — as owners.

We have gone to great lengths to explain the Board's reasoning to investors, employees and the media, and most of our audiences have come to recognize that splitting up the company just would not accomplish the desired goals.

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In addition, as you saw on August 31st, we are energetically managing the company to increase long-term shareholder wealth. We believe that as the business performs well, and as we use our cash flow to increase returns to shareholders, and as we manage through the various external issues, the stock price — and your investment — should also perform well.

As we mentioned earlier, we are beginning to see some signs that the market agrees with us. As of last night's close, our stock is up __% from its September 1993 low closing price of 45-1/2, and up __ % from the June 17th closing price of 50-3/8. *[Note: the 4/1/93 close was 64-1/8.]*

Meetings with institutions have included holders of approximately 125 million shares —

	Investors	Millions of shares	
7/19	Pacific Research	4.5	GCB, H Mill, M Kenny
7/19	First Boston	63.0	GCB, H Mill, M Kenny
7/26	The Capital Group	15.0	RWM, GCB, M Kenny
7/29	Fidelity	25.0	RWM, GCB, H Mill, M Kenny
7/29	TIAA-CREF	13.8	RWM, GCB, H Mill, M Kenny
8/16	T. Rowe Price	2.5	RWM, GCB, H Mill, M Kenny
8/19	Omega Advisors	1.2	RWM, GCB, HGS, H Mill, M Kenny
		125.0	

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Q-13. **Split-up/price.** At current price levels, what are the arguments against a split beside the likely legal challenges?

A. The legal challenges, and the delays and uncertainty they would have caused, were the principle reason for our decision not to split up the company. But as our stock price increases, the chances of a meaningful and enduring increase in value from a split-up decrease.

* * *

Q-14. **Split-up/protecting food.** Does the vulnerability of your food side increases as legal problems mount? What will you do to protect your food business? And as legal problems mount, will the odds of a split continue to decrease with time?

A. *[Refer this question to Murray Bring.]*

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Q-15. **Dividend/repurchase.** Your August 31st announcements were in the right direction, but a lot of us wanted more, and some of the Wall Street analysts agreed with us. Why couldn't you double the dividend? Or as an alternative, why can't you spend the 2.5 billion some analysts expected to buy back your stock each year?

A. As we have said a number of times, we feel that we have a number of options to increase value for investors. A more aggressive dividend posture is one. Others include continued stock repurchases; selective, high-potential acquisitions; restructuring or reducing our debt; and divesting under-performing or non-strategic businesses. But we don't want to spend all our cash, or use all our credit, in such a way that would severely limit our flexibility.

Some of the analysts who wanted to see a huge increase in the dividend, or a much larger stock repurchase plan, just want the stock to go up very fast and very far, so they can take their profits and run. But we have to manage the business, as a going concern with immense long-term growth potential, for other constituencies as well — for instance, for you as long-term stockholders, and for bondholders and employees. So we're not looking for a short-term boost that would hamper long-term growth.

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Q-16. **Dodd Litigation Reform Act.** Do you support the Private Securities Litigation Reform Act of 1994, introduced in the U.S. Senate by Senator Christopher Dodd of Connecticut? *[Question may come from Joseph Suggs, State Treasurer, Connecticut Retirement & Trust Funds.]*

A. We have not studied the proposed legislation in detail. To the extent that it would prevent abuses of power by lawyers filing groundless and onerous class-action securities lawsuits, we are obviously in sympathy with its goals.

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Q-17. **F.E.T.** What would happen to Philip Morris if U.S. cigarette taxes were raised by $2.00 a pack?

A. As you know, both the House and Senate bills from the Democratic leadership called for a 45-cent increase, to be phased in over five years. So the increase, if one materializes, is likely to have a far more manageable impact upon our business.

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Q-18. **External issues — general.** Do you believe the latest Congressional and legal attacks on tobacco have crested? Why or why not?

A. We can't say that we've reached the peak. But we believe that we are on solid ground in Congress and in the courts. We are fighting back very aggressively.

We believe that we will prevail in the courts, that Dr. Kessler and Congress should not find a role for the FDA in regulating cigarettes, and that the ridiculous proposed OSHA regulations should fall flat on their face. So we do expect that, in time, some of the wind will be taken out of our opponents' sails.

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Q-19. **Legal strategy — responsibility.** Who determines Philip Morris' legal strategy?

A. Management relies on the advice of counsel, and uses counsel's advice to make the appropriate business decision about which course to take.

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Q-20. **Why buy? (Why not divest?)** With all the uncertainty and political problems, why should we buy — or hold — your stock? Why shouldn't we divest, to avoid conflict with the health and social concerns of our members and public policies?

A. The main reason is that a public pension fund manager's fiduciary responsibility is to meet the financial needs of the members of the pension fund, by making sound investments. And by most measures, Philip Morris stock has been an excellent investment over the years.

Total average annual returns to shareholders, as of 8/31/94 close:

	10 years	5 years	1 year
PM stock	*25.83%*	*12.55%*	*31.2%*
S&P 400	*14.89%*	*9.57%*	*9.4%*

We believe that the depressed price of our stock since 1992 has been due to three main factors.

First, our defense of Marlboro and our other premium brands last year knocked about 15 dollars off the stock. Well, that strategy has proven successful, and we're close to where we were before Marlboro Friday. *[64-1/8.]*

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Second, the threat of a sudden, steep increase in federal excise taxes on cigarettes, ranging from 75 cents to two dollars per pack. As you know, both the House and Senate bills from the Democratic leadership called for a 45-cent increase per pack, to be phased in over five years. So the increase, if one materializes, is likely to have a far more manageable impact upon our business.

Third, the legal and regulatory issues. These are not going away, but we are fighting very aggressively, and we are confident that the situation will remain manageable.

There are two basic reasons our stock price should increase, beyond solutions to the external tax, legal and regulatory issues: first, we plan to keep generating superior earnings growth; and second, we plan to use our cash flow to keep providing good returns through such measures as an aggressive dividend posture, stock repurchases, etc.

We showed you how serious we are about using our cash flow to improve your returns when we announced our 19.6% dividend increase, and our new, $6 billion repurchase program, on August 31st.

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Q-21. **Layoffs and cost-cutting.** Do you see the same levels of cost-cutting in the years ahead, or more or less?

A. We already have a major worldwide restructuring under way in all of our businesses. As we reach the end of that process, in 1997, we will look at how close we are to being the low-cost, premium-quality competitor in our key categories. And we do continually examine opportunities to operate more efficiently, prune our product lines and exit under-performing or non-strategic businesses. That's just good business.

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Q-22. **Marlboro Friday.** Marlboro's share is at an all-time high in convenience stories in the U.S., earnings beat expectations for the quarter, and the stock is inching back up. In retrospect, do you think that "Marlboro Friday" and the decision to slash prices was a sound one?

A. Absolutely. The Marlboro strategy was, and continues to be, a great success — and an example of the kinds of actions we've taken in many categories and markets around the world.

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It was a success not just because it built share, but because it protected the viability of the brand and — we believe — our future profits and cash flow from domestic tobacco. If we hadn't re-adjusted our pricing, 1993 earnings from domestic tobacco would have been down from 1992 anyway — and they would have taken a much worse dive this year or next, with little hope of recovery. But now we've got a solid business base for earnings growth.

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Q-23. **Acquisitions and divestitures.** Do you anticipate more food or tobacco acquisitions or divestitures? What companies are you looking at?

A. We don't comment on specific acquisition or divestiture candidates.

I can say, though, that although we have raised the hurdle rates on all of our acquisitions, we believe there are still many attractive candidates out there. However, most of them are relatively small companies that would strengthen our existing food and tobacco operations or expand our geographic reach.

We don't rule out a large acquisition, if the opportunity is just too good to pass up. Jacobs Suchard is a perfect example of an acquisition we hadn't planned. It was a great opportunity that has paid off very well.

At the same time, we will continue to exit under-performing or non-strategic businesses, as we did with frozen desserts and frozen vegetables last year.

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HOSTILE Q&A

Questions 24-32 are based on those in a July 13, 1994 letter from trustees of the New York City Employees' Retirement System to Bill Murray. (The signatories included attendees Alan Hevesi and Mark Green, the five boro presidents, and Carl Haynes of the Teamsters.) The suggested answers come from Legal.]

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Q-24. **Health.** In the face of overwhelming scientific evidence, why do you still insist that smoking does not cause disease and death?

A. It is not our position that smoking does not cause disease and death. We have repeatedly stated that smoking is a risk factor for certain human diseases. Because of the epidemiological studies, we recognize that the statistical association between smoking and a number of human diseases establishes the possibility that smoking causes those diseases. It is a basic tenet of science, however, that epidemiology, or statistics, cannot prove causation. The 1964 Surgeon General's Report affirmed this position by saying that "Statistical methods cannot establish proof of a causal relationship. . . "

Over many years and thousands of animal studies, whole smoke animal inhalation experiments have failed to produce more lung cancers in the exposed animals than in the non-exposed animals. And there are many anomalies in the epidemiological studies. For example, the dose does not affect when the lung cancer occurs. Lung cancer is age-specific, and generally occurs between ages 50 and 70, regardless of the amount smoked or the age at which smoking began.

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Q-25. **EPA authority.** What will you do when the EPA prohibits smoking in all public places?

A. The EPA has no authority to regulate smoking, so it cannot prohibit smoking in public places.

As you know, Philip Morris has joined a number of other organizations in challenging the EPA's designation of environmental tobacco smoke as a human carcinogen. We have filed a lawsuit in the federal court in North Carolina asking the court to throw out the designation as arbitrary and capricious, because the scientific evidence does not support the EPA's action. The EPA filed a motion to dismiss our lawsuit, but the court overruled the motion and told the EPA it had to defend the suit on the merits.

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Because of the strength of our position on the science, we believe the court will order the EPA to revoke its designation.

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Q-26. **Nicotine content.** Why do you manipulate the nicotine content of your cigarettes?

A. We do not. And this was made clear in the Congressional testimony of Bill Campbell, the CEO of Philip Morris–USA. Nicotine levels in our cigarettes follow tar levels, and both are clearly stated on all cigarette advertisements and have been for many years.

Nicotine naturally occurs in all tobacco. During the manufacturing process, the levels of nicotine actually decrease by a substantial amount. No detectable amounts of nicotine are added at any time. We use nicotine sulphate to denature alcohol, which, in turn, is used to add flavors to the tobacco. The use of nicotine sulphate is approved by federal regulation, and its use as a denaturant is well-known. The amount used is undetectable, and adds no measurable amount of nicotine to the finished product.

As you know, we have sued ABC for accusing us of manipulating the levels of nicotine in our cigarettes by adding large amounts of nicotine. This is not true, and ABC knew it was not true before its *Day One* broadcast.

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Q-27. **Nicotine content — follow-up.** But you do add nicotine to the tobacco you use, and you use tobacco to which nicotine was added by suppliers, don't you? And don't you control nicotine levels in other ways?

A. As previously stated, we do not add nicotine to the tobacco we use, nor do we use tobacco to which nicotine was added by suppliers. Nor do we independently control the nicotine levels in our cigarettes. Nicotine levels follow tar levels.

By blending types of tobacco for taste, Philip Morris makes different brands with different tar yields – and thus different levels of nicotine, which follow tar levels. But we do not add nicotine which already naturally occurs in tobacco. Indeed, in response to consumer demand nicotine levels in cigarettes have steadily declined over the past forty years. Sales-weighted tar and nicotine levels have decreased 60-70% since 1957. This has been done through filtration, ventilation, use of expanded tobacco and use of blended leaf and reconstituted tobacco. Approximately 25% of the nicotine in the tobacco is lost during the manufacturing process. It is not replaced.

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Q-28. **Regulation — FDA.** What will you do when the FDA regulates cigarettes?

A. The FDA has no authority to regulate cigarettes under current law. That is why Commissioner Kessler has asked Congress for guidance. He recognizes that the current law forbids FDA regulation, as long as we do not make health claims for our products. Any efforts to regulate will be vigorously fought by the Company.

* * *

Q-29. **Regulation — general.** But why should the industry be virtually the only industry that is not regulated by some part of the government?

A. The premise is not true. Congress itself holds almost yearly hearings on the issue of smoking and health and, as a result, has, on three different occasions, actually written the warning labels that appear on every package of cigarettes and on every cigarette advertisement. The fact that Congress itself writes the warnings is virtually unprecedented.

In addition, the FTC monitors and regulates unfair or deceptive advertising of tobacco products; the Department of Health and Human Services requires cigarette manufacturers to submit annually a list of ingredients added to tobacco and is authorized by Congress to evaluate the health effects of the listed ingredients and inform Congress and the public of its findings; BATF collects cigarette excise taxes and enforces penalties for nonpayment. BATF also requires disclosure of various data on cigarette cartons and packs, regulates types of processing, and requires companies to report annually on their use; the USDA regulates tobacco as a crop. It grades tobacco before auction, inspects imported tobacco, and, in conjunction with the EPA, regulates the use of pesticides in tobacco farming; the EPA regulates the use of pesticides in tobacco farming. In addition, at the request of Congress, the EPA issued a report in January of 1993 detailing the allegedly negative respiratory health effects of environmental tobacco smoke; OSHA issued a notice of proposed rule-making in early April 1994, that would require all employers under OSHA jurisdiction to develop and implement written indoor air quality compliance plans; the Consumer Product Safety Commission issued a 1993 report on cigarette ignition propensity.

In other words, the industry is already well regulated by Congress and numerous government agencies.

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Source: https://www.industrydocuments.ucsf.edu/docs/phbk0000

Q-30. **Potential liability.** Has Philip Morris Companies analyzed the potential costs of tobacco-related product liability, including wrongful death, disease, environmental tobacco smoke, and the alleged manipulation of nicotine levels? If yes, what is Philip Morris's strategy for dealing with that potential liability and what are the potential write-downs? If not, why not?

A. Our strategy for dealing with the litigation you mentioned is to continue to vigorously and successfully defend the lawsuits, including the class-action lawsuits and the lawsuits recently filed against the industry by the states of Mississippi and Minnesota.

In substance, these new lawsuits make the same basic allegations as all previous lawsuits that we have defended successfully in the past. They are simply being dressed up differently, in an effort to circumvent the individual smoker issues such as awareness and personal choice. All are being brought in an effort to get the industry to pay for the injuries allegedly sustained by individual smokers who chose to smoke. In the class-action and state lawsuits, the plaintiffs will have the same burdens of proof as in the traditional cases brought by individual smokers. The same defenses will be available to us in these new cases as in the traditional cases. And, for the same reasons, we expect to prevail.

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Q-31. **Potential Florida Medicare suit.** But what about the Florida legislation? Doesn't that legislation make the plaintiff's case easier to win by doing away with your traditional defenses?

A. As you know, no lawsuit has been brought by Florida. We, and several other organizations representing the Florida business community, have filed a lawsuit challenging the constitutionality of the legislation. We believe that litigation will be successful, and that the legislation will be declared unconstitutional. If we are not successful, we still believe the plaintiff will have to prove causation on an individual by individual basis; that is, did smoking cause the specific individual's illness. In addition, we still have many defenses available, including preemption.

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Q-32. **General litigation strategy.** Does Philip Morris plan any change in litigation strategy as it relates to tobacco?

A. No. We will continue to vigorously defend these lawsuits and, for the reasons already mentioned, we believe we will continue to be successful.

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Source: https://www.industrydocuments.ucsf.edu/docs/phbk0000

Additional hostile Q&A.

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Q-33. **Meetings.** You talk about your communication efforts. But why did it take so long for you to set up this meeting? When will you hold the next one? When will we meet with more outside directors? *[This question may come from Sarah Teslik of the Council of Institutional Investors.]*

A. As you know, we invited a number of you to meet with us in July, shortly after we took our new positions. As I understand it, the primary obstacle was deciding on our guest list. I'm glad we got that cleared away.

Let me be absolutely clear about this. We want you to feel free to pick up the phone and call any of us in management with any of your concerns. We also welcome the opportunity to get to know you as individuals, in smaller meetings. [But as a general principle, the directors have delegated shareholder relations to management. That's our job; that's what we get paid for. So we do not expect outside directors to attend future meetings with you on a regular basis.]

When it seems as though it would be fruitful and productive to meet as a group, of course, we will consider it. But we see this kind of large and formal meeting as a remedy for somewhat troubled communications in the past, and not as a model of how we want to conduct business in the future. There are better ways for us to get to know each other. We hope that this meeting can be the beginning of an ongoing relationship.

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Q-34. **Split/RJR.** Henry Kravis and Charles Harper seem to have shareholder value in mind a lot more than you do — everyone knows that RJR Nabisco will be splitting up. How come they can do it, and you can't? Are they smarter? Do they have better lawyers?

A. Thus far, we have no reason to believe that RJR has found a way to separate its businesses. We keep track of many other companies and structural alternatives too, by the way. And as we've said, we never say never.

In any case, our situation is somewhat different from RJR's, partly because we have a much larger food company. *[$30.4 billion in 1993 worldwide sales, vs. $7.0 billion for Nabisco.]* When you're that large, certain kinds of business combinations become more complex, both structurally and legally *[anti-trust]* .

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Source: https://www.industrydocuments.ucsf.edu/docs/phbk0000

We have, however, taken a number of actions to address questions of shareholder value. We just increased our dividend 20%, for instance, and announced a $6 billion stock repurchase program. [As you may have noticed, RJR tends to work in the opposite direction — they pay no dividend, they significantly diluted shareholder value by issuing additional equity in 1992, and KKR's proposed investment in Borden helps them lessen their stake in RJR Nabisco.]

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Q-35. **Split/long-term wisdom.** This fraudulent conveyance thing is just an excuse. Some day, your food and beer companies are going to be ruined because of your irresponsible tobacco business. Even if a spin-off would take five years to get through the courts, and even if shareholder value declined over that period, there'd be a huge long-term benefit in shielding innocent businesses from the sins of tobacco. So why don't you get the ball rolling?

A. As we have said, we are confident that we will prevail in the actions currently against us. So we don't think that any of our companies, including our tobacco companies, will be negatively impacted by liabilities arising from tobacco.

In a way, the current frenzy can even work in our favor. Because when the current legal and legislative maneuvers against tobacco fail or fade in urgency, as we believe they should, there may be some sense that the anti-tobacco forces have taken their best shot at us. . . and lost.

In any case, though, the more a spin-off is undertaken expressly in order to shield what you're calling "innocent" businesses, the more it could resemble a fraudulent conveyance. We looked at separating our businesses primarily as a way to enhance their prospects. We found that it wouldn't work. But as we've said, we never say never.

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Q-36. **Split/proxy.** We don't care about your supposed reasons for not splitting up the company were. You should let us decide. Why don't you put it to a vote of your shareholders?

A. Given the legal and structural complexities — and risks — of the transaction, we believe that it would be irresponsible for us — or anybody — to proceed with a proposal to separate the businesses in the current environment.

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Q-37. **Split/Hamish Maxwell.** *[Directed to Mr. Maxwell.]* Let's forget the legal issues. Were you responsible for the decision not to proceed with a separation of the businesses?

A. [Initially, we were all prepared to vote in favor of the split, if that looked like the best course to take. But] In light of the legal and other issues we've mentioned, the Board's decision not to proceed with a spin-off was unanimous.

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Q-38. **Get out of tobacco.** You people are in perpetual denial. We think you should get your heads out of the sand, cut your losses the way the asbestos manufacturers did, and run as far away from tobacco as possible.

A. The fact is, tobacco accounts for more than half our profits, and international tobacco in particular is growing so quickly that it will soon be our largest single source of profits. Tobacco has been an immensely, and increasingly, profitable business for us for decades, and we expect that to continue.

Tobacco has also enabled us to bring you handsome returns. Even last year, when our stock closed at 55-5/8 and we didn't raise our dividend, our average annual total returns to you as shareholders came to 22.3%, 25.3% and 23.0% for the most recent 5, 10 and 15 years.

To put it simply, we just don't think there are, or will be, losses to cut. We can't really comment on the comparison with asbestos, because so many of the facts and circumstances were different. But we think that we're quite alert to the environment, and that our legal and public policy people are among the best in the country. We think we understand our opponents and their strategies, and we are confident that we have effective strategies, and contingency plans, that will enable us to manage through the challenges ahead.

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Q-39. **Get out of tobacco/change management.** In practical terms, we can't sell our Philip Morris stock — it's part of the Dow and the S&P, not to mention just about every good large-cap fund we can find. But it's our fiduciary, moral and ethical responsibility to keep you from killing our members, and to steer you away from a very steep cliff. We want you out of tobacco, and we want you out of the company. We should get Mike Miles back.

A. First, we acknowledge that smoking is a risk factor in certain human diseases. That's not the same as causation. *[See answer to Q-24.]*

As for your interest in changing the nature of the company, that is, of course, your prerogative. You might also pursue divestment more aggressively — that's also your prerogative — but we think that would be a mistake. We are determined to manage the company well for you and our other shareholders. We have a good record of doing so in our first three months, and we plan to keep increasing value for you over the long term.

If there are constructive measures you want us to take, we are eager to hear about them. But we've explained why we can't split up the company in the present environment, and we've already taken other decisive measures to increase shareholder wealth.

The fact is, the people in real denial are in the anti-tobacco camp. They're the ones who have been predicting the end of our world for the past 40 years. And they haven't just been off in their timing — they've been wildly wrong, as our growth has shown. We're the ones with the record of continued success — despite marketing restrictions, smoking bans and outrageously slanted junk science.

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Q-40. **Safer cigarettes.** If you can't get out of tobacco, can't you make cigarettes safer?

A. No one knows what "safer" means. No one, including public health officials, claims there is such a thing as a "safer" cigarette. In this context, I should remind you that we don't believe it has been established that cigarette smoking is "unsafe," if we define "unsafe" as causing certain diseases. We do, however, recognize that smoking is a risk factor for certain diseases.

We don't make health claims for any of our cigarette products. We continually look for ways of modifying our cigarettes to meet consumer demand. Our de-nicotine cigarette, Next, was one example — unfortunately, its taste was unsatisfactory.

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Q-41. **Health/addiction.** Cigarettes are the only product on the market that, when used as intended, cause death. How can you say it hasn't been proven that smoking is unsafe? And these people have no choice — they're addicted. You've hooked them. When you brag about how you're the biggest international tobacco company in the world, what you really mean is that you're the world's worst drug pushers.

A. As we have said, we don't believe that cigarettes are addictive, at least not by a common-sense and traditional definition of the word. We also know that more than 40 million Americans have stopped smoking, most of them without formal programs or medical treatment. So we believe that smoking is a matter of choice. And consistently, juries have agreed with us.

To the extent that it's a risk factor for human disease, smoking is like many other human activities that also are associated with statistically measurable risks— riding motorcycles, driving on the Long Island Expressway, eating ice cream. But statistical links, and correlation, aren't causation.

Causation would mean that if you smoke, you will get a certain disease. But many smokers don't get those diseases, however much they smoke. And many other people get those diseases anyway, even though they don't smoke. So the facts just don't support the sound bite, "the only product that, when used as intended, cause death." *[The answer to Q-24 also discusses risk factors and epidemiological studies,]*

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MORE HOSTILE Q & A

1. As you yourselves have acknowledged in remarks to other groups of investors, the litigation and public policy challenges facing this company have a material impact on your ability to achieve your goals of growing your businesses and increasing stockholder wealth.

   So that we can have a full and reliable account of the Company's evaluation of these challenges, and of its strategies to keep them manageable, we demand that the Board of Directors establish an committee of outside experts to audit the Company's legal and public policy activities and exposure, and to provide a detailed report to the Directors and the Stockholders within six months covering: (a) the litigation and public-policy challenges facing the Company, (b) the Company's strategies and defenses, and the probability that they will succeed, (c) the Company's potential exposure in each instance should its strategies and defenses not succeed.

   Such a report is clearly essential to our ability to rely on your assessment and management of these risks, just as certified financial statements are essential to our ability to rely on management's financial presentations. Will you undertake to provide this report, or do we need to embarrass you by presenting our request as a shareholder proposal in the proxy statement?

2. Only a quarter of all Americans smoke, down from nearly a half in the 1960s. What are your projections for the size of the U.S. cigarette market in the next 5, 10 and 20 years? What will you do as your domestic market, profits and political influence collapse?

   - Follow-up: Already, we're seeing a new breed of anti-tobacco legislators, even in the tobacco states. As there are fewer smokers, and fewer people sympathetic to smoking in legislatures and on juries, how will you stay in business?

3. OSHA is considering strict guidelines for smoking in the workplace, and more and more states and local communities aren't waiting — they're imposing strict regulations on when and where people can smoke. How many cigarettes will Americans smoke, if they have only ten minutes a day in which to get their daily fix?

4. What kind of deal are you prepared to make with Congress and the FDA? Will you accept limits on tar and nicotine levels, access to cigarettes by children under 21 and restrictions on advertising proven to appeal to them? (Why or why not? And what impact will such a deal have on your business?)

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5. The only real reason cigarettes are so profitable is that demand for them is so price-inelastic — probably more than for any other legal product. Isn't your pricing power proof that your consumers are hooked?

6. What happened to Marlboro Express? Wasn't that a way to give nicotine addicts the quick fix they needed?

7. Why can't you make your food business as profitable as your tobacco business? Is it because you don't really know how to run a food business? And if food can't be as profitable as tobacco, why did you invest in it in the first place?

8. You keep pointing to your overseas tobacco business, but what will happen as governments in Europe and other markets wise up? Won't you be chased out of overseas markets, just as you're being chased out of the U.S.?

9. *[If Murray Bring hasn't covered these issues —]*

   (a) What's happening with the criminal investigations into the industry by the Justice Department and the Brooklyn D.A.'s office?

   (b) *[possibly to Dick Parsons or Bob Huntley during the cocktail session —]* As directors, what level of responsibility do you accept for Philip Morris' actions? Aren't you worried about your personal liability? Are you insured? I'd think there wouldn't be enough insurance in the world to cover you.

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